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C O N F I D E N T I A L SECTION 01 OF 02 BRASILIA 000888

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SUBJECT: BRAZILIAN FOREIGN MINISTRY SAYS "NO CRISIS YET"
WITH BOLIVIA, BUT TWO POTENTIAL FLASHPOINTS ARE BREWING

REF: BRASILIA 882

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Classified By: PolCouns Dennis Hearne, 1.4 (B) & (D)

¶1. (C) Summary: Bolivia agreed not to interrupt gas supplies to Brazil, and Brazil agreed to continue investing in Bolivia's hydrocarbon industry at the May 4 meeting in Puerto Iguazu, Argentina, according to the Brazilian Foreign Ministry's Bolivia Desk Officer. This understanding has deterred an immediate crisis, he said. However, two potential crises loom on the horizon: 1) Bolivia may impose a unilateral price increase (such an intention has been reported in the press, but so far there has been no official notification) and 2) Bolivia could repossess some or all of the farms currently operated by 15,000 Brazilians who moved into the Santa Cruz region over the past twenty years. Brazil hopes that a meeting between Petrobras and Bolivian officials later this week may move the issue back to the technical arena, reducing its political volatility. End Summary.

¶2. (C) Foreign Ministry Bolivian Desk Officer Lauro de Castro Beltrao Filho told poloff May 8 that the two private commitments made at the May 4 Puerto Iguazu, Argentina meeting justified President Lula da Silva's characterization of the situation between Brazil and Bolivia as "not a crisis." At the Puerto Iguazu meeting, Bolivian President Morales promised that he would not interrupt gas supplies to Brazil, and President Lula promised that Brazil would continue to invest in Bolivia. However, Beltrao, cautioned, the commitment on investment is not airtight. Petrobras, as a publicly traded company with thousands of private investors, will be the one to ultimately decide on investment issues consistent with future conditions. He added that, while there is no ongoing crisis, the situation remains serious and could develop into a crisis in the near future.

Gas Prices, Agricultural Reform, Could Provoke Crisis

¶3. (C) Bolivia could foment a crisis in one of two ways. First, it could unilaterally impose a gas price increase. Beltrao noted that La Paz had already publicly indicated an intention to raise prices by 61 percent, but the Brazil side had received nothing official from Bolivia in that regard.

Since, according to the contract Petrobras has with Bolivia, the price of gas is to be decided by mutual agreement between both sides, a unilateral price increase would constitute a breach of contract. (He noted that an adjustment mechanism is built into the contract to allow prices to fluctuate yearly based on a market basket of goods, and that every five years or so, the two sides will engage in a more comprehensive renegotiation of the price.) Beltrao pointed out that regional gas prices had been gradually rising so Bolivia might be justified in requesting a price increase. However, it would have to obtain agreement from Petrobras before implementing an increase.

¶4. (C) A separate, but related, issue is the status of some 15,000 Brazilians who moved into the Santa Cruz area of Bolivia over the past twenty years and who are currently growing soybeans on farms in the region. Most moved from neighboring regions in Brazil, attracted by soil that is richer and land prices that are cheaper than those found on the Brazilian side of the border. Beltrao noted that on the same day as the gas nationalization was announced, the Morales government also indicated its intention to carry out agricultural reforms that could affect those Brazilian farmers. Any action taken that would threaten the rights of those farmers would occasion a public outcry in Brazil, probably worse than that caused by the spectacle of Bolivian soldiers occupying Petrobras facilities. Beltrao noted that Brazilians had been particularly shocked by that display, and he attributed much of the popular criticism of President Lula's response to the outrage over those images.

Hoping to Move Focus Back to Technical Issues

¶5. (C) According to Beltrao, there will be a new round of talks over nationalization in Bolivia this week. He said

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Petrobras will conduct the talks, most likely without government participation, as Brazil would like to return the issue to the technical arena, thereby turning down the political temperature. He said he was unaware whether Bolivian Government officials would join YPFB at the meeting.

¶6. (C) Comment: Whether or not the Foreign Ministry is prepared to acknowledge a current "crisis" between Bolivia and Brazil, there clearly appears to be a crisis of confidence in Lula's foreign policy team. Press criticism of the Lula administration continued over the weekend, with the largest newsmagazine pillorying President Lula's chief foreign policy advisors for their handling of the Bolivian episode, and several other international setbacks, labeling them at one point, "Sheep in Sheep's Clothing."

Chicola